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Q3 2003 Taser International, Inc. Earnings Conference Call

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## PRESENTATION

### Operator

Good day ladies and gentlemen and welcome to the Q3 2003 Taser International Incorporated earnings conference call. At this time all participants are in a listen only mode, with a question and answer session to follow the presentation. My name is Mike and I will be your conference coordinator today. If at any time during the call you require assistance please press star followed by zero and a conference coordinator will be happy to assist you. As a reminder this conference is being recorded. I would now like to turn the program over to your host for today's conference Mr. Tom Smith, president of Taser International. Please proceed, sir.

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### Tom Smith *Taser International - President*

Thank you and good morning. And welcome to our conference call for the third quarter. And for the people that are dialing in onto the phone, and this applies only to the people on the phone when you sign on we are using slides so you can view the numbers as we speak to them. I want to make sure you don't have any problems so only for the people on the phone, when you dial in there will be selections after you register which will allow you to choose to use media player, real player or a third option that says live telephone. You need to make sure you're on the live telephone for this so you will have the audio muted but you'll actually see the slides move in real time. If you pick one of the other two links there will be a 20-second delay. Again for the people on the phone only between the voice and the people signing on watching the slides move. So I will give you a second to make sure those are up there. We will go slow and make sure the slides are moving forward. Before we get started, how about that quarter? Let's turn it over to Doug to get this process started.

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### Doug Klint *Taser International - General Counsel*

Thanks Tom. Certain statements contained in this presentation may be deemed to be forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. And we intend that such forward-looking statements be subject to the safe harbor provisions of that act. These forward-looking statements relate to expected revenue and earnings growth. The company's estimations regarding the size of its target markets, the ability of Taser to successfully penetrate the law enforcement market, growth expectations for existing accounts, the ability of Taser to expand its product sales to the private security military and consumer self defense markets and the company's target business model. We caution that these statements are qualified by important factors that could cause actual results to differ materially from those reflected by the forward-looking statements in the presentation. These factors include but are not limited to market acceptance of the company's products, Taser's ability to establish and expand its direct and indirect distribution channels, Taser's ability to attract and retain the endorsement of key opinion leaders in the law enforcement community, the level of product technology and price competition for the company's advance [inaudible] or products, the degree and rate of growth of the markets in which Taser competes and the accompanying demand for its products and other factors detailed in the company's filings with the Securities & Exchange Commission. I'd now like to turn the call over to Rick our CEO.



**Rick Smith Taser International - CEO**

Good morning. Before we get into the numbers financially, I want to start with some even more important numbers. And this slide speaks to the source of value for our customers, and in any company we believe that is the source of value for our shareholders as well. What I'm showing here are the results of our field reporting database. We have had 3,333 field reports submitted through our website. Now, we estimate that we only get one in ten field reports actually submitted to us. That's because most of the larger agencies do not even submit. For example, Los Angeles PD, Seattle, all of the big ones maintain their own use of force database and for their own legal reasons they don't participate in third party databases. So most of the reports we get tend to get from smaller agencies. Out of that 3,000 reports we have 412 lives saved and that's basically rated by evaluating the use of force reports between the users and our evaluators here who ready them and they come to the conclusion that that 412 cases, had the Taser not been on scene, it's likely a life would have been taken, either physical force or in some cases the subject was in the process of taking their own life, usually with an [inaudible] when the Taser was used to intervene. So with the field success rate of 94%, we're just feeling great about the way our product is performing in the field and as we move through this conference call I think you'll see our customers are really taking to the product line as well.

So with that, let me move into talking about the financial data. I'm sure everybody here has seen the press release. We are obviously quite excited about the results that we've had this quarter. And very enthusiastic about our future. First the big picture. Comparing Q3 versus the prior year. As you can see our sales are up 216% to 6.1 million. Our gross profits are up 254% to 3.5 million. And our net income went from a net loss last year to 1.1 million in earnings this quarter with record profitability of 18%. In what is normally Q3, of course, is our normally our worst quarter. It's normally a down quarter and it's one where we've just had a tough time. But we believe the market momentum has now swung our direction overpowering the regular seasonality and leading obviously to some results we feel great about.

Moving on to the next slide we'll look at comparing Q3 versus our prior record quarter which was Q2 of this year. And we bested our own record by 46% of the top line and 41% in gross profit and by 210% in net income. Again, numbers we all feel good about. Kathy will talk a little bit more about the gross profit number. We had some handicaps this quarter that we'll talk about coming off of the fourth quarter that will help to make our future numbers even better. I think the biggest strategic accomplishment of the quarter is that the new Taser X26 is now shipping. We announced the X26 in May and began shipments in September. Took us a little longer to get the product out to the field than we'd initially planned, but part of that was we decided to go through a longer pre-release validation program. We did a lot of extensive testing to make sure the quality control was in place and it's paid off in spades. We've had very few problems in the field, very few product returns and the product is rock solid out of the gate. The X26 is going to do for us what the flip phone did for Motorola over the old "brick" phones. It's this reduction in size that takes our technology from the M26 which is a great weapon platform but it was a little cumbersome for day-to-day use. We've now compressed it down making it 60% smaller, 60% lighter and packaging it with a holstering system, so the time out of the box to the officer's belt is a matter of minutes. And again we believe that convenience now makes this amenable to full time carry by law enforcement officers across the country and the market feedback we're getting is just phenomenal. They love it. We are getting -- in fact most of the market feedback we're getting I can't think of one negative we've got on the X26. People are telling us we nailed it, it's a 10.0.

Also from our shareholder perspective, company perspective obviously we invested a lot of time and money investing in the Taser and that's paying off with improved margins. The X26 is a premium product with premium performance. It is the first USB universal serial bus enabled in the world and got much more complex software. It's the only weapon I know of and one of the few devices perhaps that tracks its own warranty information internally, we've just got a great feature set to this. And what that does again, improved margins and we're seeing user acceptance. I guess the best way to point out our user acceptance is within the first few months we had the Phoenix PD, one of the top ten agencies in the country, turn on a dime and they saw this weapon, they immediately went to their City Council and they've got approval, happening in Q4 to upgrade their entire M26 deployment to the Taser X26. We think that's a great indication that the current market penetration of M26 users are all people we can go back to with the X26. It resets our market penetration or at least our potential market to 100%. We can go back to our existing users with an improved product. Also Phoenix broke ground in another area, they became the first major agency to make the Taser X26 part of their uniform. That means every new officer will be issued a gun, uniform, a baton and a Taser. And of course long term that means great things for our company. It speaks a lot of confidence from Phoenix and long term it makes our selling job quite a bit easier frankly. We shipped 1,922 in the first month of production. So we went from 0 to 60 pretty quick.

In terms of other strategic accomplishments. We really started off two significant partnerships this quarter with General Dynamics on the



Taser Mine. Those of you who may recall from our last conference call, we bought our competitor Tasertron and frankly at the time I did not put much value in this concept of a less lethal land mine because it is not something that I understood. I got to tell you I was dead wrong. This past quarter I've gone to several meetings with representatives of the various armed forces, the Department of Defense, General Dynamics, and I can tell you there is a huge potential for less lethal area [inaudible] systems and we are in the lead position. This has been a real jewel in the rough for us. Again, we did not see this when we bought Tasertron. We bought them for other strategic reasons but we're now looking at this Taser mine has the potential of being larger than our hand held business for the next [inaudible] or so. When the U.S. military deploys a technology it is not abnormal for them to have lots of zeros after the number of things they buy. So this could be a tremendous business opportunity and an opportunity for us to support our war fighters in the field. Obviously something we feel good about.

With Patel, Patel is a not for profit research organization. In fact I think they're the largest non-government research organization in the world and we have contracted them on some of our long range Taser research that we're doing in conjunction with the United States Marine Corps system commands and the Office of Naval Research. We have made great strides in the R&D there. But like the X26 you'll not see those in until the technology is going to market. You'll see more to come on other partnerships. We have had a lot of high quality companies and organizations coming to us. They've seen our position of leadership and we're trying to find ways to leverage our core value and I'll talk about that at the end of the conference call today by partnering with great companies to put ourselves in a position where we can add more value to ourselves, shareholders, customers than we could do solely on our own.

Intellectual property comes in to play a great role. What are the barriers to entry and the key IP for Taser, today was a great day for us in another area. The M26 patent issued today, U.S. patent number 6636412. For those of you who take a look at it, this is a very broad patent that basically covers any hand held electrical weapon systems that operates from 0.9 Joules per pulse up to 10 Joules per pulse. That basically covers from about half the take down power of the M26 up to something that would be so cumbersome and large that that would be impracticable. We believe this is a key blocking patent and the fact that it issued today is going to put up a real barrier for entry anybody who tries to follow us down the road with the M26. Also the Taser mine patent which came with what we purchased with Tasertron, we were notified it was accepted in Europe, where patents are very broad. We have patent coverage in the United States and now we have patent coverage in France, Germany and I believe five other European countries where we've filed. So we've got block patents throughout basically all of NATO and western Europe on the Taser mine.

Looking to the future, the X26 is on file, so we talked about the M26 patent has issued now. The X26 coming out, the X26 uses a more refined energy pulse that's even more novel than what we did on the M26. We believe that that patent is going to be just dynamite. That's been filed in the U.S. and we do intend to file the X26 patent broadly worldwide in every major country where we would see a strategic opportunity for a competitor to arise or for significant market to develop. And we have two more patents in application process at this juncture that also have key technologies, and you'll learn more about those in the coming years.

Other strategic accomplishments, we hired a new Vice President of product development, Dave DeBay. We think he will be a very key add on in our team. Dave DeBay was with Primer(ph) Holdings, Defense Technologies Company DEVtech has been the worldwide leader in pepper Sprays and attack munitions, long range 43mm and top gun launch bean bag rounds, sponge baton rounds, basically DEVtech is the name worldwide in long range impact devices. We believe that number one, his background in safety testing and product development will help us and of course his skill set in looking at long range systems which is one of our areas of research will be a real dynamite add.

We also see an acceleration in R&D in Q3 and Q4. Now we have got the X26 up, stabilized, and transitioned into production, our skunk works are busily looking into new areas. And you'll see that reflected in our level of spending on our Office of Naval Research project, the land mine kicks off. We have our kickoff meeting next week where we'll start kicking that into full gear and again look for a lot more good things coming down the road. As part of this we're putting this new strategy forth. Taser is an enabling technology. Don't think of this as just a single product or two product lines. The ability to incapacitate the human nervous system through electrical stimulation is a very complex field. It is one in which we have key patents, wave form patents that are issued and more pending. And we believe that core technology can be applied to lot more than hand held stun guns, land mines, long range systems, things that can be deployed from aircraft for military use or naval assets. So there's a lot of areas we can expand into and we're really focusing on developing our core technology and our core IP.

You've seen the record profitability. Even with the handicaps I'm going to talk about here, in Q3 we held back \$360,000 of M26 revenue that



was deferred to Q4. Basically because we have a trade-in program for new agencies to buy M26's, they could upgrade to the X26 by year end, our auditors have worked with us on a very conservative program so we've basically held back \$360,000 worth of revenue from the third quarter that will recognize in Q4 when that trade-in program goes away. I should point out that there is no cost of goods allocated against that for Q4. We've taken the cost of goods for \$360,000 in revenue, that hit this quarter, that is one of the things that impacted our margins, next quarter we pick up the revenue with no COGS. Also the X26 production fallout during scale up. Any time you put a new product into production there's learning curves. You've got fallout during the production ramp as you learn about your processes, what works what doesn't, and we've absorbed that fallout mostly during Q3. And again, even with that we've seen the record profitability. We think Q4 will have stronger gross margin numbers as our production yields on the X26 are greater and we pick up these deferred revenues. We've also improved our productivity measuring systems. Our operations are really, really becoming world class and Kathy's done some phenomenal things I'm let her talk about them. With that I'll turn it over to Tom to talk about sales.

**Tom Smith Taser International - President**

Thank you Rick. One of the things I'm going to start off with is really looking because we get a lot of questions about how many units are out there and how many departments are out there. So in this particular slide we're really going to give it to you graphically so you can see exactly how many units are being used out there in the field worldwide. What you're looking at here is that top blue dark line is showing the growth and expansion of the number of units that are out there from day one introduction of the Advanced Taser, which was in 2000, through the current quarter and you can see as of the end of the third quarter we have over 53,000 M26 Advanced Taser units out there in the hands of law enforcement worldwide. The line below that, the green line on the screen is showing the number of agencies. And you can see again another nice upward trend to the right as of the end of last year 2000 agencies, we've added over 1500 agencies through the first three quarters of this year bringing our total to over 3500 agencies. You will notice we will be tracking as we go forward obviously with the introduction of X26, you will see the pinkish line, showing 1922 ships during the third quarter, and I'd like to really again emphasize that those shipments didn't occur until really beginning the late the first week of September. So even with that late of a start in on that new product, manufacturing was able to get that many out within the first month. So as we go forward that's numbers that we'll be tracking and you'll be able to see them graphically appear.

One of the other things obviously that we're very, very excited about is the message point that we started during the fourth quarter of last year which was safety for every officer, and the Taser needing to be out there for those front line guys. It obviously takes time for a message point to get out through the channels and to be absorbed and what we're showing here is that message point is being adapted by the law enforcement community in the number of full deployment. As of the end of the fourth quarter last year we were only at 159 and you can see we added 40 during the first quarter of this year. We added another 40 agencies during the second quarter and then again a trend you're going to see as we go through this presentation, a doubling during the third quarter in the number of agencies that are going full deployment. We have 82, bringing the total number of agencies which have committed to full deployment, meaning one on every officer out there, to 318 at the end of the third quarter. Again another nice upward trend that is going to the right we expect to see that continue as we continue to pound that message of safety every officer deserves along with the new message point that Phoenix adopted which is its uniform patrol equipment, one for every guy coming out of the academy as well.

Now let's take a look at those Taser weapon sales graphically. There are key points to look at here. Fourth quarter and first quarter of this year we were selling about 4600 M26s. That jumped up to 6600 in the second quarter. And obviously one of the things we were wanting to keep our eye on was what was the new Taser X26 going to do to impact the M26. You can clearly see here we did not see any falloff. The M26 isn't going away. It is a very field tested battle proven product that has a bright future along with the Taser X26. Giving people more options out there. And again you can see with the addition of the X26 during the third quarter we shipped 8871 Tasers out to the law enforcement to use on the streets to protect themselves. Those are numbers we will track as we go forward.

As we move on, the cartridge sales, what you're looking at here is two different slides that will compare the ratio and quantities that we're shipping. As you can see in the first quarter which was really the anomaly right there we went from seven to one during the fourth quarter of last year to a 19 to one in the first quarter this year. That's really when a lot of the agencies go do their annual training on the officers that has to be done yearly. That's why we see a big jump in the ratio and you see the consistency that we are planning right now, 12 cartridges for every weapon. Manufacturing, hats off for them doing a great quarter. A big jump from 80,000 cartridges during Q3 to 105,000 cartridges during the third quarter. Again, numbers that we like to track for the ratios to make sure those are constant and you can see that they're sustaining themselves as well as the increase in production for the demand that we're seeing from the law enforcement community.

As far as our market penetration goes, we started at 11% as of the end of last year. We are up to 20% of the agencies, the top green line on the screen there, we're up to 20% of the agencies, and that's documenting that there's 18,000 departments in the United States, and these are United States only numbers. We have 20% or 3500 of those departments. And kind of letting everybody go through business school and they always talk about that magic number of 15% market penetration, once you kind of get past that the market really starts to move on its own which we'll get to in a minute. You can see we've successfully gone through that number at the end of the third quarter. The on the blue line on the bottom of the screen, penetration for the number of officers. So what you're seeing there at the end of the third quarter is we had 20% of the agencies out there but we only have 5% of the sworn law officers in the United States. So that's again what you'll see in reorders, as new agencies -- or new orders go forward, is agencies that may have ten or 20 are coming back now buying 100 or 150, as they are now seeing the success the Taser is giving their men on if street and they're adding more to their arsenal. So it's not just the new sales that are driving us, it's the reorders from existing customers. So obviously with only 5% there is enormous upside to go back to the agencies that we have as current customers to add more units to their arsenal.

Some of the sales accomplishments. We now have all fifth top PDs now deploying the Taser including New York, Chicago, LA, Philadelphia and Houston. So again now as of the end of that third quarter getting Chicago during the quarter, we now have all top fives deploying the Taser at some level in their departments. There's now a real acceleration in growth. We have 3500 agencies which is up 754 agencies during the third quarter. Again it's kind of our double-double. We have the doubling in the number of agencies that went from Q2 to Q3 in full deployments, we also doubled the number of agencies that we added. We added 411 in Q2, we added 754 during Q3. And as I mentioned earlier, 82 are now full deployment up from only 34 during the second quarter. One of the other things I'd like to go through right here also is the number of orders that we process during this quarter. In the second quarter, we processed 1833 orders, this quarter we processed 2634, a record number of orders coming in here again. And the dollars per order in the second quarter was \$2312 -- excuse me \$2283 versus \$2312 during the third quarter. That is very significant for us also because it says the growth we have seen didn't come from one large bluebird order, it is the consistency of the base out there for both new and existing customers to continuing to order and we aren't relying on a single or one or two customers coming through to give us the growth that we're seeing. It is coming from a consistent base that's out there that's established and obviously we do keep an eye and track that number as well.

In addition to the 20% of the agencies using the Taser now we also were able to get Congress convinced in the power of this weapon, and they put in \$1 million specifically into the defense appropriations bill for fiscal year 2004, which started on October 1st, for the U.S. Army to spend \$1 million on Taser equipment between now and September 30th of next year. And I can tell you we can't comment a lot on our military sales right now, there are a lot of things going on that you will be hearing some more this quarter, and next year. But obviously with \$1 million being set aside that's just the beginning for the military. They are showing quite an interest in this. Obviously they are interested in our R&D programs and we do expect that number to be going up. We will put out as much information as we can as we work with the military in the next 12 to 18 months.

During the third quarter we successfully announced Switzerland. The Swiss have adopted the Taser and made it available to all of their police. Here is a small neutral country situated in the middle of Europe. They looked what's going on in Germany and the U.K. and U.S. and Canada, did their own test and evaluation. Promptly went to the conclusion that this is going to have a tremendous impact and made available for the police to buy. Again it is not a huge country but it is the trend of making this available for everybody that we want to see continue, and as they work through budgeting issues which all governments are facing these days we expect to see numbers to start to order even some late this year we hope and the majority of those will be next year we believe, not in huge numbers.

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**Rick Smith Taser International - CEO**

If I could just chime in there just to clarify, Tom, that -- so the people understand, it's been approved at the line level officer level by the government for deployment. They have not funded a full deployment. It's just been approved at that level. So in terms of how many they actually purchase, that's going to depend on budgetary restrictions.

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**Tom Smith Taser International - President**

Thank you. The United Kingdom, let's talk about that test. That test began in April of this year, with a field test involving 5 agencies. The test is going phenomenally well, better than expected and it's obviously meeting the expectations we had planned and hoped for. That test will run through next April. It was a 12-month test. Where they're at right now they have seven documented uses. And again we're not getting any





inside information, all we're hearing is what's reported in the press as well. There are seven documented uses, including one on a dog and a drive stun, where they've fired the Taser. They have 100 times when the Taser has been present on scene with 100% compliance. Meaning the Taser is there as an option. And when the suspect was told the Taser was there, they complied without having had it used on them in that situation. They are having tremendous success on the product not only deterring criminals but in its use as well. They are running a fantastic success rate over there and we believe again that there are probably more uses that we aren't even aware of. There should be a mid term report coming out later this month or early next month. As we get that we'll be able to put out some more information about that. We're obviously very enthusiastic about what's going on in the U.K. There was an article interview with the head of the program over there who is talking right now he can foresee in the near future that the Taser would be present in a minimum of every patrol car in the United Kingdom. Again we feel in talking to the line officers using it in the United Kingdom that they are going to press to get one on every officer as we are seeing here adopted in the United States. Again that will be subject to budgetary issues next year. But the results are speaking for themselves. The United Kingdom will have a huge impact globally. The old commonwealth still has a lot of influence out there. As soon as that trial is done and they start those deployments, it will get other countries waiting in the wings to move forward and follow the leads of the U.K. and Switzerland in that aspect.

We went and visited Australia during the third quarter, [spent three weeks down under. Training] all the federal police -- not all, the federal police, customs, the military and every state in the country of Australia except one in the use of the Taser. They are currently in field trials with fantastic result. Not a huge country but we expect to see large results coming out there in the next 12 to 18 months. Global acceptance of what we're seeing here in the United States.

Lastly I'd like to discuss some of the large quotations that we have out there. As I mentioned before the number of orders and the dollars per order are very consistent for us on a day-to-day basis but with the success the Taser's been having over the last three years we are now getting some quotations out there that are really really large. I can tell you I've got at least a half a dozen quotations out there with order quantities that are greater than half of what we've done in this entire year, and I've got a couple of them, several of them out there that the quotation is for numbers that exceed the quantities that we've done this entire year. Again, in a single order. Now, that's not saying there's any guidance there or any promises that those are all going to come in. But I would expect during the next 12 to 18 months that we will see one to two of those very large orders come to hit and move forward. We had discussed last quarter, we had a very large overseas military purchase and deployed 3348 of our units. Believe it or not that was just a field test for them. We expect to see large numbers come again some time next year. Doubling at least on that particular country. And again there's as I said six or seven large ones of those out there for quotation. Have a high degree of closure. We won't have every one of them but if one or two of those, it will have a significant impact on our business in 2004 and 2005. We are very, very excited about what lies ahead for us.

If we look at what's ahead for this market situation, we believe we've crossed the tipping point in market momentum. We've just really crossed into the point now where the market is beginning to move itself and propel itself forward. We have agencies selling other agencies. Guys talking where they're in situations where they can share information, saying if you don't have this you need this. It really works. And people who are just seeing it for the first time that are really getting their eyes open to how powerful this technology really is. So a lot of the momentum is coming out there with the efforts we've done but also in the use in the street by the line officers.

As a closing point before I pass it off to Doug, just to give you again, when we're looking for the fourth quarter we've updated our guidance to go to 20 million for the year and we're at 13.7 already. As of yesterday, for the first part of the fourth quarter, we've already booked 2.2 million in new orders. So if you add that to the additional 1.7 million in the backlog that we had at the end of Q3, we're looking at booked numbers as of today for the fourth quarter of 3.9 million. Approximately, in book numbers. Again, just telling us that those orders are continuing to come in at a steady pace. There's no big blue birds that have hit yet, just consistent orders and the adaptation of the product by those line officers. We are excited about what lies ahead. The momentum is continuing to kick in. You'll expect to continue to see exciting growth as we move forward. With that I'll hand this over to Doug Klint, our general counsel.

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**Doug Klint *Taser International - General Counsel***

Thanks Tom. I'd like to give you a brief update on how we're proceeding. I'd like to point out that none of the pending litigation will have any material impact on our operating results or financial condition. We have two nuisance lawsuits that are currently pending. One involves a suit by the estate of a person who died of a drug overdose while in police custody. The other involves by the City of Madera concerning a firearm shooting by a police officer who claims she thought she was using her Taser weapon. Both of these lawsuits are fully covered by our



insurance and although these are the only use of force lawsuits that have been filed against the company in ten years of business, we have implemented an aggressive risk management program that should limit Taser's liability for this type of litigation in the future.

Other pending litigation is the McNulty appeal. McNulty sued us in 2001 claiming patent infringement for trigger mechanism. We were awarded summary judgment in 2002, McNulty filed an appeal. He has currently missed two deadlines for his appeal. [audio gap] Hennigan lawsuit, we were sued by a former distributor in Ledge(ph) Oregon, we were again recently awarded partial summary judgment on some of the claims. We are waiting for the court's memorandum to determine the actual scope of the summary judgment. Finally, we have filed litigation against UBS Warburg and other pseudonyms that they were posting false and defamatory statements about the company on the Yahoo message board. We have obtained IP addresses for pseudonyms for Yahoo pursuant to subpoena, however, unfortunately, the Internet service provider that had these IP addresses was unable to trace them for us due to a loss of their business records. We are now seeking alternative information from Yahoo to help track down these individuals.

Finally, I'd like to comment briefly about our new facility that we're in the process of starting construction. We are in escrow for the purchase of 4.5 acres in Scottsdale for a new building. And we are currently finalizing design of the building with our architect, and the slide you see the front elevation of the new Taser headquarters. We are considering a two-phased building project that could give us a total of 100,000 square feet. We are expecting to start construction in first quarter 2004. I'd now like to turn the call over to Kathy who will present a manufacturing update.

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**Kathy Hanrahan Taser International - CFO**

Good morning. As you've heard Rick and Tom talk Q3 was a record quarter in just about every facet of our business. We shipped record number of orders. We saw record sales. We made significant improvements in progress in our R&D program. And we successfully launched a new product into market. Manufacturing was no exception to that level of accomplishment. We successfully implemented a second shift in August of this year, and within 30 days were up 50% in capacity. We implemented a productivity program where we can monitor each individual operator at each step of the process to identify weaknesses and areas for improvement. We ramped our Taser X26 product from zero to 2000 units in less than 30 days. This is a \$24 million run rate within 30 days of production. Now I know from the calls that I get, Phil sees the same type of thing coming through.

There are a lot of you that question can manufacturing keep up with the revenue numbers that are coming in. My answer to you is yes. Our current facility within 60 days will be ramped to support revenue of \$65 million. That comes from 2,000 M26s per month 5,000 X26's per month and approximately 90,000 cartridges. We plan to do this by expanding our second shift and also through the use of automation.

In terms of financial performance, let me begin with sales. As Rick and Tom discuss we increased sales by 216% or \$4.2 million in the third quarter of 2003. We also increased sales by 46% over Q2 which was previously our record quarter of 4.2 million. Year-to-date sales increased by 95% or \$7 million. This increase is more than our entire 2001 sales. In terms of gross margins we've realized an improvement of \$2.4 million in Q3 or 6% of sales over the same period last year. This is resulted from operating efficiencies and higher sales volume. Gross margins improved by \$1 million in the 90 days ended September 30th, 2003. As a percentage of sales gross margins declined. This is a result of the deferral for the M26 which comprised about 1.8% of sales and the Office of Naval Research. In our contract with the Office of Naval Research is a fixed plus 8% fee. When we do the significant activity like we saw in the third quarter, this will impact our gross margins as it did by 1.8%.

Year-to-date gross margins increased by \$3.9 million or 2% of sales. Again, this is a result of improved manufacturing efficiencies, and higher sales volume. Our combined SG&A and R&D declined by 29.1% of sales to 28.5% in the third quarter of 2003. This area continues to be a focus for our management team as we leverage our operations towards future growth. This slide marks the point in our financial success. Our sales growth from Q2 to Q3 of this year was \$2 million yet our SG&A remained relatively constant in terms of dollars spent. The percent of sales improved by approximately 14%.

Year-to-date we're seeing the same trend. Investing -- investments in SG&A and R&D have increased by \$1.4 million over 2002 but the percent of sales expense has fallen 14.8% to 36.7%, another record milestone. This graph probably best illustrates our comments this morning. Over the last two years we've made steady improvements in every facet of our business. Cost of goods sold improved 2% per year. SG&A hit a new low of 34%, 5% less than our target business model. And we achieved operating income of 20%, 186 -- excuse me -- 186%



improvement in 24 months. Quarterly net income also surpassed our original 2003 expectations, up \$1.1 million over the third quarter of last year. And up 210% or \$729,000 over our record second quarter of last year. Year to date, net income was up more than 1,000% to \$1.7 million for the year. That's 1 million more than our 2001 and 2002 earnings combined. Our basic earnings per share figures show the same dramatic improvement, climbing 53 cents year to date to, 58 cents per basic share. This excludes approximately 9 cents per share in revenue to be recognized in our fourth quarter.

Unlike many companies experiencing high growth rates we're generating significant cash flow. In the nine months ended September 30th, 2003, we generated \$3.8 million of cash. That figure coupled with the \$5 million generated through warrant conversions has increased our reserves to \$12.3 million as of October 15th of this year. In terms of our sources of cash for Q3, 37% of our cash was generated from operations. \$1.1 million coming from net income. The balance came from financing net of our investment activity. During the third quarter we invested \$153,000 in fixed and intangible assets.

This slide further breaks down our cash from operations. As with many growing businesses we've invested both in inventory and accounts receivable. During Q3 depreciation and amortization contributed \$106,000 in cash. The tax benefits from 73,000 option exercises generated \$469,000. Accounts payable contributed \$897,000 and our net income contributed approximately \$1.1 million of cash in the quarter. In addition to monitoring operations, we also target key balance sheet accounts. Days sales outstanding is targeted at 29 days for the company. In Q3 days sales outstanding were 35. This was the result of \$3 million in revenue shipped and invoiced in September of 2003. Inventory is another target area. Our goal is to turn our entire inventory balance eight times per year. In Q3 we increased to 7.7 turns even with the addition of nearly \$500,000 of new X26 materials. With that I'd like to turn it back to Rick to discuss our stock performance.

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**Rick Smith *Taser International* - CEO**

Okay, we're putting up on the screen here the history of our stock performance since our IPO. And wanted to point out a couple of turning points. Obviously our stock is up dramatically this year. We're up 12.7 times from our \$3.30 low, and you know obviously we've been taking calls from people asking, you know, hey is there upside left in the stock and I think the resounding answer to that is yes, there is tremendous upside growth opportunity.

Let me first take you through a quick history of our stock. We came out in 2001. Obviously September 11th of that year had a dramatic impact on a lot of things in this country. One of them had to do with aviation security. In late 2001, we received the order from United Airlines when they selected the Taser as their weapon of choice for their cockpits. Those of you on our October 2001 conference call you'll recall that we tried to put in perspective the airline industry, that it is significantly smaller than our core law enforcement business. Nonetheless of course there was a lot of momentum to the stock at that time. A lot of people got interested in it because of the airline business even though that's not our core. In June of that year Congress passed the bill to arm pilots with handguns and I think at that point a lot of the people that were trading on the momentum of this airline publicity lost interest in the stock, and it came down accordingly. Again, we did not see at that time that that downward movement was related to anything in the fundamentals in the company but more so just in the momentum of -- some of these momentum players in the stock market.

Over the course of this year as we've seen our performance continue to improve with the introduction of the X26 which was a revolutionary new product in this area and our financials, supporting the growth you've seen here, we've seen a tremendous ramp in the value of our stock. But we think that it's fundamentally sound and supportable by the financial growth of the company.

Couple of quick ratios that we've looked at to validate that. If you take our most recent quarter earnings per share of 36 cents you annualize that at \$1.50 a share per year, again annualized most recent quarter, we are trading at a PE of 30, on basics EPS. If you take the more conservative route and you look at annualizing the fully diluted number of 25 cents a share, the stock as of yesterday was trading at a price ratio of 43. Again that is annualizing most recent quarter. [audio gap] And for a company that's growing at a 100% clip, generating cash as profitable as we are we believe these numbers are sound and fully support the stock price where it's at today and there is still tremendous opportunity in the future. Phil, let me have you talk a little bit about what we're doing in investor relations, as it relates to our stock price in Q4.

**Phil Smith *Taser International - Chairman of the Board***

Well, I wish I could take credit for it all but obviously I can't. The one thing that is not on this chart is we do have one very large holder that I went to visit personally in Canada. They own 350,000 shares of our stock. Public information, it's Sprout(ph) associates. Fine group of guys, they're long term holders. They love the story. As long as we keep performing they'll hold on the stock. We will go to the [inaudible] conference in New York on November the 11th. There is individual Chinese wealthy investor conference the on the 12th of October. This Sunday I did the one in Vancouver, we had Chinese investors buy the stock. It's been a good spot for us. It did well for us last time. And then we've got the Business Week, we're going to advertise in this Microcap and review this on December 15th, so you can look for our add in there. The only other thing is one Microcap conference in Phoenix, being sponsored by an IR firm and that's it. Obviously we'll go out on call and see as many people in New York that would like to see us. We have had invites from folio managers. We'd love to take the time if they take the time to see us. With that Rick will turn it back to the future of the company.

**Rick Smith *Taser International - CEO***

Okay, talking about the future and again we believe it's just a lot of bright things coming. First let me start with marketing. We are now shifting from -- we're augmenting our strategy of officer every safety deserves to this concept of uniform safety that the Taser needs to become part of your uniform. And as part of that we have a couple of things going on. The first one if you look at the picture there we've got Bernard Carrick, this week at the international association of chiefs of police, largest gathering of industry leaders of law enforcement in Philadelphia this year. We are sponsoring a luncheon with Bernie Carrick, who just got back from Iraq, amazing guy, board member of ours. Bernie went from being the commissioner of NYPD during the 9/11 attacks to the sheriff of Baghdad within two years. We think that this will be a huge draw to get the police chiefs in to learn about the challenges of setting up the national police force from scratch in a place like Iraq. The second half of that luncheon is going to be dedicated to a round table where we have eight chiefs of police from Portland, Denver, Phoenix, Las Vegas metro, Orange County, and a couple of other agencies that will talk about the impact Taser is having on their patrol officers. And of course Phoenix will talk about how they've now made this watershed move to make the Taser equipment. We believe that that roundtable is a tremendous event for us. We did one last year, we think that was part of the success over this past year in driving this message home at the upper levels of law enforcement.

Similarly, we're going to be sponsoring our second annual Taser Europe conference. In May of this year in our second quarter we did our U.S. Taser tactical conference. That is our primary marketing vehicle to the tactical user community. And this is one where you've got to succeed in law enforcement at both the high administrative level of the chief and you've got to win the hearts and minds of their product experts and tactical guys. So the U.S. conference has been a driving force here in the U.S. We have 26 countries that have now registered to attend the conference in Europe. That's going to be a big event for us this year and with the events unfolding in the U.K. and some other countries in Europe we believe this conference will help drive it forward.

Another thing we will be doing in Q4 are customized cost benefit reports. It will be going out to around 15,000 agencies. You can really see it very well out there but we've actually done these customized reports. We did them last year with great reception. This year we refined our approach even more. Basically we can show numbers that are calibrated to each department. Each PD will get a CD on our product and then on the cover of the report they'll see we customize it with the patch from their law enforcement agency and we show them the numbers, based on your number of officers, we believe you can save X million dollars over the next 10 years based on the Taser deployment program. We come up with these numbers based on Los Angeles county sheriffs reduction in liability, Orange County sheriff's reduction in officer injuries, and Phoenix PD's reduction in suspect injuries, we can show them that under conservative assumptions the Taser program pays for itself in approximately 13 months. This has been a powerful selling tool with City Councils, mass mailing in Q4, again pushing this idea of now integrating the Taser into your uniform which becomes a practical reality because of the Taser X26.

Moving from marketing to this concept of the Taser technology as a platform and a core enabling technology. If we look at the graphic here, as you can see today we operate in the area of hand held Tasers. On the far left. And ammunition on the far right. We also believe there are other burgeoning opportunities in area denial, the Taser land mine and the long range Tasers. And we believe there will be more opportunities to expand the use of our operating system so to speak. Sort of like Windows was the operating system that propelled the PC revolution, we're not aiming to be Microsoft any time soon, but we do believe that the wave forms are the enabling technology, this is the operating system of the most effective less lethal weapons available. And our goal is to maintain control of that operating system and partner with other folks like General Dynamics who can add value like systems integration, in areas where we don't have core competence, such as



sensor systems, system integration, network centric mine fields, things outside of our expertise, we'll partner with other folks who can broaden out the total value position.

Talk a little bit more about that Taser land mine. This is a long term proposition because this is purely a military, we don't see a large private market for these systems. Although there are some private security area denial applications. So this is going to be developing over the next five years. But the concept they're showing here is using hand placed arrays of these Taser devices that would be integrated into these self-contained arrays where basically these could be used for area denial and all sorts of interesting applications. One of which would be for example when our troops were rolling into Iraq, and I talked to some soldiers who had returned recently from Iraq, it was so wearing on them that they had to spend -- 50% of the personnel had to be awake at any time on watch. And when they were moving on the major military movers, the fatigue was incredible. They've said the ability to deploy a barrier system that is non-lethal would be tremendous. Obviously they don't have time to lay out wire or put up huge barrier systems, they can't go out in land mines especially in urban combat situations, where you can see the risk of a child wandering into a lethal mine field is too risky. Less-lethal mine fields have great combat augmentation abilities, by giving the ability to secure certain areas in a non-lethal fashion and then also to secure areas around buildings, ammunition dumps or places like Korea where the military could see the use of non-lethal land mines bordering on lethal mine fields so that people who are innocent who could make a mistake and wander into that area would get engaged first by a non-lethal weapon. If that person gets up and elects to continue and eventually into the lethal mine field, that they sort of self-selected themselves as a hostile at that point. So there's all sorts of military applications for the Taser and again we are really excited to be partnered with General Dynamics. We are partnered with their general, entrepreneurial group of people we're excited to be working with them and we think there's huge opportunity there. So with that, I'm going to open it up to questions and put up the last slide. Of course any IR questions or investor questions are best sent to Phil@taser.com. Let's open it up for questions.

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## QUESTIONS AND ANSWERS

### Operator

Ladies and gentlemen, if you wish to ask a question press star 1. If your question has been answered press star 2. Once again if you would like to ask a question please press star 1. And the first question comes from Steve Gibbs with Roth Capital Partners. Please proceed.

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### Steve Gish *Roth Capital Partners - Analyst*

Congratulations on the good quarter. Just a couple of housekeeping items, first of all, the 449,000 in deferred revenue that will go straight to the bottom line?

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### Rick Smith *Taser International - CEO*

Yes. That's correct.

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### Steve Gish *Roth Capital Partners - Analyst*

And where would we see that effect, though? Would it be in net cost of goods sold?

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### Kathy Hanrahan *Taser International - CFO*

You'll see it in gross margins. We'll recognize that revenue piece with no associated cost of goods sold in the fourth quarter.

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### Steve Gish *Roth Capital Partners - Analyst*

Okay. Around how much deferred revenue did you have in Q3?

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### Kathy Hanrahan *Taser International - CFO*

\$349,000. 359, I'm sorry because the total is 449,000 for the year.

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### Steve Gish *Roth Capital Partners - Analyst*

I'm sorry 349?

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**Kathy Hanrahan Taser International - CFO**

359.

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**Steve Gish Roth Capital Partners - Analyst**

59?

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**Kathy Hanrahan Taser International - CFO**

Right. Plus 90,000 from Q2.

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**Steve Gish Roth Capital Partners - Analyst**

Okay, and did you have scrap this quarter like you did in Q2?

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**Kathy Hanrahan Taser International - CFO**

We did, with manufacturing fallout. There was about 83,000 that was generated in the scrap from the different prototypes. We also set a reserve as we talked about last quarter for obsolescence in inventory as we move forward with the air Taser dropping off, we also are making conservative with the M26 product so we have no surprises going forward.

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**Steve Gish Roth Capital Partners - Analyst**

And the Taser Europe conference scheduled for this quarter have you accrued for that or would we see that charge in Q4?

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**Kathy Hanrahan Taser International - CFO**

You'll see that charge in Q4 when the trade show actually takes place.

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**Doug Klint Taser International - General Counsel**

Let me comment about that. The other thing we're doing, that two-day conference, the first day will be a training course. As Rick said we have 26 countries that will be represented there. The second day will be presenters and the majority of those presenters are actually from the European users that are out there from Switzerland, the U.K., Germany, Finland. So the nice thing about that is then it rolls right into Milipol. Milipol is the largest security show that occurs in Europe, only every two years. Sunday-Monday is the Taser conference and Tuesday goes to Milipol. So we're going to be getting a lot of people attending our conference that are also attending Milipol. It was a great draw for us to do that right before the largest trade show in Europe.

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**Steve Gish Roth Capital Partners - Analyst**

If I'm looking at this correctly in terms of your guidance or your hope of earning \$1 per basic share, if you have a similar quarter or slightly stronger quarter from Q3 and factor in the deferred revenue that should enable you to meet that target?

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**Kathy Hanrahan Taser International - CFO**

That's correct.

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**Steve Gish Roth Capital Partners - Analyst**

And how much additional cash flow will you raise when and if you call the warrants?

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**Kathy Hanrahan Taser International - CFO**

There are about 600,000 warrants that are left outstanding at \$9.53 a share. So it's about \$6 million that will come in with that.

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**Steve Gish Roth Capital Partners - Analyst**

Okay. And any immediate plans on how to effectively deploy that cash?

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**Tom Smith Taser International - President**

Not at this point. We're being conservative on the cash flow. We actually are planning on the land purchase that we're doing. We're probably going to take that out of cash rather than, you know, borrowing money at a higher rate. So we'll spend \$3 million out of the 12 we've got right



now purchasing the land. The balance of cash at this point, you know, it's oxygen. We're going to sit it in the bank and guard it carefully. We're investing in areas such as automation. We're looking at automating some of our lines. We think that's a good place to deploy some of our capital as well. At this point we don't have significant uses of cash that will chew into our reserves.

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**Steve Gish *Roth Capital Partners - Analyst***

Rick, you have a lot of demonstration and training events coming up and sometimes there is a registration fee. Is that a meaningful revenue contributor at in point or in the future could it be?

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**Rick Smith *Taser International - CEO***

Right now it's not. We hope to get to a break-even right now. It's a loss for us but really I consider it more of a marketing tool. And the reason that's the case is that better than 95% of the people or agencies that come through those trainings end up purchasing the equipment. We do charge for the training. I don't see increasing the charge for the course and we do use it for vouchers and give-away's to get new target-specific agencies to come and attend and learn about the equipment. I'd hope to get it to break even at one point but I don't see it being a profit center. It is not a focus for us. We are using it for a sales and marketing tool and knowledge exchange of the weapon equipment.

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**Kathy Hanrahan *Taser International - CFO***

Year to date the revenue received from training year to date is about \$250,000.

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**Steve Gish *Roth Capital Partners - Analyst***

Okay. And two last questions and then I'll get off. In terms of the M26 and X26, do you have an estimated shelf life, in other words, the deployments that you're seeing now when could we expect them to either upgrade or make repurchases over the years, and secondly, with your revenue guidance for this year, looks like it will be 100% year-over-year growth. Are those similar targets we could expect for 2004 and 2005?

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**Tom Smith *Taser International - President***

Let me comment on the first part, that is, these agencies move forward, it is hard to put a time line, especially the larger agencies. Phoenix reacted extremely quickly for being the sixth largest in the country which I think is an anomaly, speaks to them being one of the leading agencies. We don't have specific time lines but I can tell you as I mentioned before, we do have numerous large quotes out there and the biggest challenges that those cities and departments are going to face is now they've determined the equipment works and they want it is trying to get the funding for it. Funding has been limited because of the decrease in the economy and taxes for the cities to work with. A lot of these cities are trying to get grants and use grants. The launch is there. We're trying to help them find pots of money in federal grants and block grants to get this equipment. I can't give you specific time frames that we would see at this point.

As the future goes we're excited about the growth but we are just one month into the X26 at this point. We really are still waiting to see what's going to happen with that when it gets out there. So we don't have any specific guidance for next year. We'll be getting that out later this year. As of today we're still trying to digest the full impact that product is going to have on us going forward before we really get into projected guidance for 2004 and 2005. Other than we do obviously expect some very exciting continued growth. As I mentioned I have got several orders out there the quantity of those orders for some foreign countries exceed what we've done in this entire year in September 30th in a single order and that's not even the whole country. Those are initial orders. Any one of those come in, in addition to everything that's going on domestically and all the other countries around the globe, we're obviously excited about the future but we don't have any specific guidance at this time.

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**Steve Gish *Roth Capital Partners - Analyst***

Tom, just for clarity, you're saying that some of the activity or the size of the potential orders out there could be above \$20 million for one agency?

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**Tom Smith *Taser International - President***

That's correct.

**Steve Gish Roth Capital Partners - Analyst**

Okay. I assume that would be for a federal agency or deployment within one country?

**Tom Smith Taser International - President**

Correct. In the United States, we have 18,000 different agencies, and each of them is their own buying entity. Whereas let's take the U.K. for example, there's 120,000 plus officers over there. But it's a single buying decision that's made by the home office that once that decision is made it affects the entire country. So rather than dealing with 18,000 different agencies like we do here in the states we're dealing with one specific agency that would make that decision for the entire country.

**Steve Gish Roth Capital Partners - Analyst**

Okay, and in those cases would you expect to receive a large contract or would it come in phases or be some sort of indefinite delivery, indefinite quantity type arrangement?

**Tom Smith Taser International - President**

I think we would see a combination of both. I think you would see some that would come in with very large order or commitment up front, phased deliveries, not only the challenge of getting the product there but also the challenge of getting individuals in and trained. Because obviously that is the key to successful deployment is have the personnel trained in its use. So I do think we'll get commitments like we saw with the 3300 unit order earlier this year where we'll get a large commitment on an order and then there will be follow-on orders over multiple years to implement that. For example the United Kingdom even if they go with their recommendation now of patrol cars, people have estimated there's between 30 and 50,000 patrol cars as a start I think you could see a very large order come in for that some time next year with a phased, you know, plan as those come in and they get the officers trained. And those are the things that we're in discussion and they're planning right now that take quite a bit of time on these overseas commitments.

**Steve Gish Roth Capital Partners - Analyst**

I'm sorry, just one more thing. Kathy if you could mention the current capacity you have again if you could go through that and I'll get off the line. Thank you.

**Kathy Hanrahan Taser International - CFO**

In the next 60 days we'll be ramped up to support a \$65 million run rate. So that would be approximately 2000 M26s per month 5,000 Xs and roughly 90,000 cartridges.

**Doug Klint Taser International - General Counsel**

Certain disclaimer. This is not guidance. That's just our capacity.

**Steve Gish Roth Capital Partners - Analyst**

Understood. One other thing, between the X26 and the M26, if you tend to have more demand for the X26 can you shift the capacity for the M26 over or is it difficult to do that?

**Kathy Hanrahan Taser International - CFO**

We're doing a couple of things on our second shift. When we first brought it on line we were doing it to support all the auxiliary processes and the cartridge lines in particular because we had to ramp that so hard. We've also in the last two weeks brought up all the support for the X26 on the second shift and that's where we're going to continue to add personnel but slowly. The X tends to be a little bit more labor-intensive and the skill level for the assembly operators a little bit different. We are going to take that slow but we can absolutely shift people around. The other thing that we've done is we are negotiating on 8,000 additional square feet. So if we have to move the auxiliary lines out and expand the production very quickly we can do that. We are working with our vendors to make sure they have all the materials that we have allocated so we can bring them in very quickly. With Tom I've worked with him for eight years. It is not a matter of if he delivers that order, it's when and we have to make sure we're ready for him.

**Steve Gish Roth Capital Partners - Analyst**

In anticipation, your inventory levels were great this quarter. Would we expect to see those build up in Q4?





**Kathy Hanrahan Taser International - CFO**

We are doing things that are more creative. We're working with our vendors where they're actually building their inventory levels to support. We're giving them purchase orders so they're increasing their security capital so they can deliver for us. But we want to bring in just what we need for our quarter.

**Steve Gish Roth Capital Partners - Analyst**

That's it thanks.

**Operator**

Next question comes from Robert Molam (ph) with RMCC. Please proceed.

**Robert Molam RMCC - Analyst**

Gentlemen, ladies, wonderful job.

**Tom Smith Taser International - President**

Thank you.

**Robert Molam RMCC - Analyst**

Quick question, has anyone exercised the warrants at the \$9.23 discounted price that you know of?

**Kathy Hanrahan Taser International - CFO**

Not as yet.

**Robert Molam RMCC - Analyst**

9.29, isn't it?

**Kathy Hanrahan Taser International - CFO**

Right.

**Robert Molam RMCC - Analyst**

If I'm not mistaken, once the warrants are all exercised, and you earn a dollar share you will contemplate splitting the stock?

**Doug Klint Taser International - General Counsel**

Robert, this is Doug Klint.

**Robert Molam RMCC - Analyst**

Hi Doug.

**Doug Klint Taser International - General Counsel**

We're considering all different types of options but we've not made any decision on anything at this point.

**Robert Molam RMCC - Analyst**

Okay, all I wanted to know it. Thank you very much.

**Tom Smith Taser International - President**

Thank you.

**Robert Molam RMCC - Analyst**

Take care.



**Operator**

And the next question comes from James Plontsger (ph). Private investor. Please proceed.

**James Plontsger - Private investor**

My question has already been answered. I wanted to know in a previous press release, you said there could possibly be manufacturing issues and being able to scale for the business coming in. So you've answered that I appreciate it and wonderful job.

**Tom Smith Taser International - President**

Thank you very much.

**Operator**

Next question comes from George Boltrays (ph) with Boltrays Investment Partners. Please proceed.

**George Boltrays Boltrays Investment Partners - Analyst**

What is the average for the cartridge of the five-nine that you did in the quarter how much came from cartridge?

**Kathy Hanrahan Taser International - CFO**

In the quarter our cartridge revenue was about 28% of sales. It was just over \$1.6 million.

**George Boltrays Boltrays Investment Partners - Analyst**

And how about the gross margins on the cartridges?

**Kathy Hanrahan Taser International - CFO**

The gross margins are roughly 50 to 55% depending on the cartridge.

**George Boltrays Boltrays Investment Partners - Analyst**

And how is the gun powered? Is it battery or is it in the cartridge? Is there any opportunity to sell batteries or something like that, another aspect to the business?

**Tom Smith Taser International - President**

On the M26 it's powered by AA batteries, eight of them that fit into the handle, we highly recommend nickel metal Hydride rechargeable batteries. We sell the recharger as well as the batteries. The X26 it is a proprietary battery pack that we produce that has specific enabling software inside that is going to be covered under the patent that we've applied for with the X26 and the only place they can get that battery is from us. And particular battery is disposable. It is a Lithium cell so at the end of the use of that battery they have to come back and get more batteries from us for the X26.

**Kathy Hanrahan Taser International - CFO**

And just to answer your question in the quarter, we had \$170,000 revenue generated in that, in the nickel batteries and chargers.

**George Boltrays Boltrays Investment Partners - Analyst**

And you mentioned \$3 million for the land. How much for the rest of the facility in Scottsdale?

**Phil Smith Taser International - Chairman of the Board**

We don't have any firm numbers on that. We're still working with the design architect to come up with a design. We should have some construction numbers by the end of the year though.

**George Boltrays Boltrays Investment Partners - Analyst**

And then finally how do you prevent the criminal element from acquiring the product? Or is there an opportunity for the mass market that's living in New York city, I could --



**Tom Smith *Taser International - President***

Well, unfortunately the state of New York has some archaic laws in place where consumers cannot own a Taser. So you can own a gun but you can't own a Taser in the state of New York. Now, most states, 43 of them can sort of see the inherent oxymoron that that presents, or the inherent problem that presents. We live in a country with over 200 million firearms in the hands of the general public. And in that type of environment, whether you're pro-gun or anti-gun, once thinking about the issue, less lethal weapons is a de-escalation, should be available as an option, defend one's self without taking a human life. Things we do to prevent criminals from using these products, we have implemented the only ammunition trace program in the world, called AFID anti[inaudible] identification, all of our cartridges are serial numbered and when they're fired they discharge serial numbered tags. We can track that back to user registration. That's been very successful in the 43 states where you can buy Taser and maintaining that ability and gaining them the support of law enforcement because obviously it makes their job easier and it's served as a major deterrent. We do sell Tasers to the public but have had very few crimes committed with them because of that deterrence.

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**George Boltrays *Boltrays Investment Partners - Analyst***

Thanks a lot.

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**Operator**

Next question comes from James Baker, private investor. Please proceed.

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**James Baker - *Private investor***

Congratulations again folks. Do you have significant key man/lady life insurance?

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**Kathy Hanrahan *Taser International - CFO***

We do have key man life insurance right now on both Rick and Tom adding it for the rest of the executives is something that we'll take a look at on a going forward basis.

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**James Baker - *Private investor***

Personally, I would feel better if you did that on a significant basis.

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**Phil Smith *Taser International - Chairman of the Board***

Jim, we are not driving these C-6s like you drive.

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**James Baker - *Private investor***

Or like your turbo-force GT, right?

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**Phil Smith *Taser International - Chairman of the Board***

On the young ones they do.

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**James Baker - *Private investor***

Great job, folks, thank you.

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**Tom Smith *Taser International - President***

Thank you.

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**Operator**

And the next question comes from Eric Nuttall with [inaudible] Asset Management please proceed.

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**Eric Nuttall *Sprott Asset Management Inc - Analyst***

Good morning, everyone, congratulations.



**Tom Smith Taser International - President**

Thank you.

**Eric Nuttall Sprott Asset Management Inc - Analyst**

R&D side I guess we're looking at a ramp up Q4 over Q3. Any ballpark numbers as a percentage of sales?

**Tom Smith Taser International - President**

I don't think that it will necessarily be a ramp up over Q3. In Q3 we expended quite a bit in our research contract with Patel. I'd say it would probably be flat in Q4 from Q3, in terms of the overall dollar value spent on R&D. Where we'll really see the difference is the labor hours of our engineering staff, a lot of it was dedicated to bringing the X up and into production. They've now transitioned that over to manufacturing. So it won't be so much something you'll see in the financial numbers as it is going to be that it's just we are now free to allocate their time to the next projects.

**Eric Nuttall Sprott Asset Management Inc - Analyst**

Okay. Last question I had, on the manufacturing side for the new facility, I guess we're looking at groundbreaking Q1 of '04. Any guesses as to when that facility will be up and running from a manufacturing perspective?

**Rick Smith Taser International - CEO**

We expect to be moved in Q4 next year.

**Eric Nuttall Sprott Asset Management Inc - Analyst**

Okay.

**Kathy Hanrahan Taser International - CFO**

And we have had really good experience moving manufacturing, when we initially started we were in the States, we moved down to Mexico and moved back to the States and were up and running in a matter of days.

**Rick Smith Taser International - CEO**

And moved five times while we are in Mexico for four years.

**Kathy Hanrahan Taser International - CFO**

I don't anticipate we will run parallel operations until we're up and running and can keep the product flowing.

**Eric Nuttall Sprott Asset Management Inc - Analyst**

Between the Xs and Ms is it all domestic suppliers?

**Kathy Hanrahan Taser International - CFO**

We have a key supplier in Taiwan that we've worked with for the last seven years.

**Rick Smith Taser International - CEO**

Eight years.

**Eric Nuttall Sprott Asset Management Inc - Analyst**

Obviously no concerns at all as far as sourcing parts?

**Kathy Hanrahan Taser International - CFO**

Well, I'm not going to say no because with the volumes that we're coming up on we are taking a look at bringing alternative sources on. Right now we have great partnerships with our key, but there are a number of things that we're going to make sure we have in place so we don't get caught off guard.



**Eric Nuttall Sprott Asset Management Inc - Analyst**

That's great, great. All right, that's all the questions I have look forward do another great quarter.

**Tom Smith Taser International - President**

Thank you.

**Operator**

Next question comes from Joe Blankenship (ph) with Source Capital. Please proceed.

**Joe Blankenship Source Capital. - Analyst**

Wonderful quarter. One clarification on share count. What is the share count after the recent exercise of warrants, and would the diluted shares, 4.2, be fully -- the full diluted count as of now?

**Kathy Hanrahan Taser International - CFO**

Okay. The actual shares outstanding at the end of the quarter was 3.2 million. Fully diluted share count with all options, and this includes options that have not yet been issued would be 5.7 million shares.

**Tom Smith Taser International - President**

This is important to point out, those are options that are just in approved plans but it doesn't mean they're ever going to be issued.

**Rick Smith Taser International - CEO**

What is the captive amount to give, what number, I think it's 5.4, right?

**Kathy Hanrahan Taser International - CFO**

Correct.

**Rick Smith Taser International - CEO**

5.4 million is the fully diluted all-out number of issued options and everything else?

**Kathy Hanrahan Taser International - CFO**

Right.

**Joe Blankenship Source Capital. - Analyst**

After your recent warrant exercise, what would be the basic share count?

**Kathy Hanrahan Taser International - CFO**

It would be roughly 3.7 million.

**Joe Blankenship Source Capital. - Analyst**

Okay. Thank you. Many of my other questions were answered.

**Tom Smith Taser International - President**

Thank you.

**Operator**

And the next question comes from Mark Westman from New Salem Capital. Please proceed.

**Mark Westman New Salem Capital - Analyst**

Great quarter. If you are successful in reporting a \$1 per basic share, what does that translate into fully diluted earnings?



**Tom Smith Taser International - President**

We'd have to project the share price as well as the earnings. So that's going to depend on obviously where the stock price is at. Which is one reason we don't ever project on a fully diluted basis. Because we are trying to guess our earnings, subject to variances because of large unpredictable orders, and we're trying to predict our stock price. So it becomes an exponential effect in terms of the risk of putting that sort of prognostication out there.

**Mark Westman New Salem Capital - Analyst**

Okay. Phil, you had put a program in place to sell some of your shares which obviously now was a little bit early to put that program into place. Have you completed those sales of shares?

**Phil Smith Taser International - Chairman of the Board**

They were sold back unfortunately at 28 and 32. But I had to get some off the table, specifically. But those were all sold quite some time ago, back in September as a matter of fact.

**Mark Westman New Salem Capital - Analyst**

Now, I recall you were contemplating doing a second round. Has that gone into place yet?

**Phil Smith Taser International - Chairman of the Board**

No, I'm not going to. There are things that Tom has talked about that I'm going to wait and see. We think we've got a lot of big ones on the fire here. I know the stock hit 51, I'm not on terminal but I saw it was at 51. I think the stock's got a lot of room to run before the year's out so I'm in no big hurry.

**Mark Westman New Salem Capital - Analyst**

Correct me if I'm wrong, but the way I read it as far as the backlog at the end of the third quarter that was the same level at the end of the second quarter, right?

**Tom Smith Taser International - President**

That's correct.

**Mark Westman New Salem Capital - Analyst**

Basically it was a 1.0 book-to-bill for the quarter?

**Tom Smith Taser International - President**

Correct. And the other nice thing about that is the manufacturing did adapt and increase that, absorb that 46% increase not only on the sales side but obviously getting that product out. And I think I should also point out that at the end of the second quarter we had a bunch of M26 product that was back ordered as well as X. At the end of the third quarter it was only X related orders that were back ordered. All the Ms were cleared out and cartridges were taken care of and we ended up with those on the shelf. It was only the X26 orders that were back ordered because obviously we'd been only into production during the month of September.

**Mark Westman New Salem Capital - Analyst**

Barring some massive order at the very end of the fourth quarter do you expect to have that backlog eliminated?

**Kathy Hanrahan Taser International - CFO**

We're certainly going to take a run at it but Tom is going to keep a run at keeping ahead of me too.

**Mark Westman New Salem Capital - Analyst**

Okay. In the last few weeks there were news reports of people, I think two men dying in Taser related incidents. Obviously in one of them apparently was shot three times, so something went wrong there. But obviously, there's no question that there's going to be more such incidents going forward and you mentioned in the conference call that you're going to have kind of a risk, aggressively manage the risk of lawsuits in this. Can you go a little bit further into that?



**Tom Smith *Taser International - President***

Before I turn it over to Doug to talk about what he's doing let me address the idea of in-custody deaths. First of all, in a couple of these we had multiple shots that were deployed on some of these subjects, some cases there were misses or clothing penetration failures with the Taser where they then, I believe in that case the Taser in the third shot successfully subdued him. But we are expecting we're going to see more and more in-custody deaths occur. According to the centers for disease control there are 20,000 drug overdose fatalities in the United States every year. Of those 20,000 people early symptoms of a drug overdose, particularly if you are dealing with stimulants such as cocaine or PCP, includes bizarre psychotic behavior, unexplained violence, paranoia, behaviors like running around naked with a steak knife cutting yourself and threatening anybody who gets near you.

That type of behavior is a perfect profile for a police officer to use a Taser to subdue you. The Taser is not going to impact the ongoing bloods chemistry if it's going to lead to a fatal end point. We've been very successful in working with law enforcement agencies preemptively, you are going to have in-custody deaths occur and that they need to be prepared for that and not jump the gun and draw a conclusion or a causal effect between the Tasing and the death. Every coroner's report that has come back has exonerated the Taser and has said the death is clearly explainable based on the level of narcotics or other medical conditions that were already ongoing in the subject that they subdued. But that being said let me turn it over to Doug to talk about how we're trying to mitigate some of our exposure because you're right the natural impetus of the family of any of these people is to try and go sue anybody they can rather than accept that it was the behavior of the subject.

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**Phil Smith *Taser International - Chairman of the Board***

One additional item I believe is going to worth mentioning, a Taser going to kill you, it is going to kill you when you shot and not a half hour later or the day after. That's what's really upsetting about the media, they grab the first piece of news, coroner's report clearly said the Taser had nothing to do with it, the AP put out a story, Taser kills the man. And we went after them and got them to withdraw that story. The media is quick on the trigger and short on facts mostly all of the are cases so far. Go ahead Doug.

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**Doug Klint *Taser International - General Counsel***

Thanks Phil. The underlying theory behind our program is simply that Taser should be responsible for the typical manufacturing risks. And that is strictly just the operation of the weapon itself. We are not the experts, and we do not dictate policy for police departments on how they deploy it, where it fits in their use of force continuum, or even post deployment issues. Those are things we have no control over. The standard operating procedures vary from agency to agency and it is not appropriate for us to train on those issues, to give any instruction on those issues or to have any liability on those issues. And as a result, we have upgraded our contractual terms and conditions to make it clear that the agencies are assuming those risks and responsibilities, since they are the experts in those areas, we've also revamped our training, where we are training just on the operation of the weapon itself, and we are asking the agencies to do their own training on deployment, use of force, and post deployment issues. And also, we've entered into an insurance agreement, whenever we provide insurance coverage through our product liability insurance, to the different agencies, where they acknowledge that they, in fact, are assuming these risks. And so far, we've had good success with it.

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**Mark Westman *New Salem Capital - Analyst***

How did -- how are you going to address this risk if you actually do deploy into the consumer market in any great extent?

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**Rick Smith *Taser International - CEO***

Well, this is Rick coming back. To be perfectly honest the risk in the consumer market we see being substantially less than in the law enforcement market and the reason being that law enforcement are using this weapon on a daily basis. Most consumer weapons that are deployed, whether pepper spray or guns are very rarely if ever used in comparison so the usage incident rate is much less. In those case people is using it in self-defense, it's much different. Basically law enforcement is seen as deep pockets. Every law enforcement agency we deal with is embroiled in a number of use of force litigation suits. In many cases they are arresting somebody who as part of their defensive strategy immediately sues the agency on some theory that their rights were abused, that the police used too much force on them and it becomes part of their defense against whatever criminal charge that they're being subjected to.

We've sold 100,000 or so Air Tasers in the consumer market and we've never had a hint of a problem in the consumer areas. It's really that the risk in law enforcement area is just that law enforcement becomes such a lightning rod for litigious folks, that their suppliers bear some

risk of being drawn into that. And Doug is trying to put a great wall up between us and that level of liability. And we've been very surprised how well it's been received by law enforcement. They understand that we private companies can't stand up and start taking on the liability that is simply inherent in being a law enforcement agency.

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**Mark Westman** *New Salem Capital - Analyst*

One last question for you. You mentioned that the order flow is pretty strong in the first couple of weeks in October. What's been the mix of M26 and X26?

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**Tom Smith** *Taser International - President*

Actually we've been watching that really -- it's been right at about I'd say 50 or 60% are still M26 orders. At the beginning of the quarter, the third quarter, it was around 75% M and it's dropped back to 50 to 55%. And I think it's going to settle right there for at least the rest of this quarter. But obviously with the size difference, I think the X26 is going to overtake the M26 sometime next year and that's why you'll notice in Kathy's manufacturing numbers we've increased the X26 numbers to accommodate that so we will be able to handle the growth. With Phoenix moving over to the X26 and kind of being the bell weather as one of the top four cities, we expect to see that occur. I don't see M26 going away at all, I see X26 surpassing it.

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**Mark Westman** *New Salem Capital - Analyst*

Has there been backlash from the distributors? My understanding you're taking a little bit more of the margin from them. Has there been any backlash on the X26 side?

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**Tom Smith** *Taser International - President*

Not really. I mean obviously they weren't thrilled with that. But one of the biggest things we did that I think really had an impact with the distributors is we had them come and attend our tactical conference in May so they got to be down there and listen to the law enforcement market and they've really become proactive. And we've also put a program in place that if they aren't adding value to the distribution chain, we're not going to just write checks to these people just because they're in a region and somebody out of that region bought. So I think they're really seeing that the value that they can contribute is going to make up in the volume for the reduction in that -- in the margin there. And it's really not that big of a reduction. But obviously we had some complaints but I think we're able to work through all of those.

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**Rick Smith** *Taser International - CEO*

This is Rick. Let me expand on that. We spent a lot of time looking at pricing issues. And on the M26 our total margin percentage was frankly out of line with the industry. It was pretty high which was good during the early phase of getting the M26 out there. As we introduced the X26 and Dr. McBrady from Warden took us through the whole pricing exercise and looking at the value chain, the total gross margin and total dollar value is the same on the M and on the X. So in terms of a unit of effort expended by a distributor selling our product, they are making the same gross value in what they are showing. In terms of the margins, it is lower on the X but it's more in line with industry standards. And I think what our distributors are seeing is because the X is so much smaller the volumes are so much greater, or at least the potential, because it can be put on every officer's belt that at the end of the day they're going to be making a lot more money through the volume.

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**Mark Westman** *New Salem Capital - Analyst*

Well, listen it's a fantastic quarter. Looking forward to another one next year, next quarter.

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**Phil Smith** *Taser International - Chairman of the Board*

All right, we'll do our best.

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**Mark Westman** *New Salem Capital - Analyst*

Okay, thank you.

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**Operator**

Next question comes from James Pang with Pacific Tech Solution. Please proceed.

**James Pang** *Pacific Tech Solution - Analyst*

The question here is on the press release yesterday, you had 1.7 million revenue booked. So far. Is that correct?

**Tom Smith** *Taser International - President*

That was a backlog at the end of the third quarter. As of September 30th.

**James Pang** *Pacific Tech Solution - Analyst*

But so far this time, and how much you booked, revenue?

**Tom Smith** *Taser International - President*

As of yesterday, we have booked for the month of October 2.2 million, that's in addition to the 1.7 million that we had as of September 30th in bookings for the quarter. So we're at 3.9 million in booked revenue, if you count the backlog plus the new business that we've written during this quarter.

**James Pang** *Pacific Tech Solution - Analyst*

Okay, that's my question. Congratulations. Wonderful job.

**Tom Smith** *Taser International - President*

Thank you very much.

**Operator**

And there are no further questions at this time.

**Tom Smith** *Taser International - President*

I think we wore them out. Thanks, Mike.

**Phil Smith** *Taser International - Chairman of the Board*

Thanks everybody for attending the conference call. We'll look forward to talking to you later this year and early next year.

**Operator**

This concludes your conference call. Thank you for your participation today. You may now disconnect.

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